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GATT Rules On U.S.-Japan Semiconductor Accord

A panel appointed by the General Agreement on Tariffs and Trade has ruled favorably on a European Community complaint that the 1986 U.S.-Japan semiconductor accord violates free-trade rules, although it rejected claims that the pact gave U.S. firms privileged access to the Japanese semiconductor market. The panel did not find the entire pact illegal, as Washington has pointed out, only Tokyo's method of implementing it. The finding, which must be approved by the GATT council, will at best make the task of policing the chip accord more difficult; at worst, it could threaten the use of administrative guidance to support Japan's domestic and foreign economic policy.

forces in the Far East in terms of both quality and quantity and the intensification of related [military exercises] and activities." As in other aspects of bilateral relations, however, U.S. policymakers will watch to see whether these words are actually translated into action.

Barbara Wanner

FY 1988 Tax Reform Proposed In Japan

Attempting to address domestic and foreign concerns, the government's Tax System Council approved a draft fiscal 1988 tax plan March 25. Repeating last year's theme, the proposal focuses on reducing and simplifying individual income taxes. To pay for the reduction and to assure future income, the plan calls for a major indirect tax. Fulfilling a pledge to the European Community, an overhaul of the alcoholic beverage tax system is also outlined. In brief, the plan covers the following areas:

Personal income taxes - The number of brackets will be cut in half to six, with rates ranging from 10 to 50 percent (see Table). Although this change was already slated as part of the FY 1987 tax reform plan (see JEI Report No. 20A, May 22, 1987), the minimum taxable amount will be raised from Y1.2 million ($9,600 at Y125=$1.00) to Y2 million ($16,000). The changes are expected to pare Y3 trillion ($2.4 billion) from FY 1988 revenues and to keep personal consumption growth strong.

Proposed Personal Income Tax Reforms

(in millions of yen and percent)

Current FY 1987		Proposed FY 1988			
		FY 1987 Plan		FY 1988 Plan	
Income	Rate	Income	Rate	Income	Rate
Y1.5	10.5%	Y1.2	10.0%		
2.0	12.0			Y2.0	10.0%
3.0	16.0				
5.0	20.0	5.0	15.0	5.0	15.0
6.0	25.0				
		7.0	20.0	7.0	20.0
8.0	30.0				
10.0	35.0	10.0	30.0	10.0	30.0
12.0	40.0				
15.0	45.0	15.0	40.0	15.0	40.0
		Above 15.0	50.0	Above 15.0	50.0
30.0	50.0				
50.0	55.0				
Above 50.0	60.0				

Source: Ministry of Finance

Local residence taxes - The number of brackets will be reduced from seven to four and the minimum taxable income will rise from Y600,000 ($4,800) to Y700,000 ($5,600).

Corporate income taxes - The rate reductions planned in FY 1987 will be implemented without change. The tax base will be widened, however, by eliminating rules for tax-free reserves and other deductions.

Indirect taxes - The plan calls for a broad tax on goods and services based on one of three models: a value-added tax similar to the European system; a transactions tax; or a general consumption tax. Of the three, the VAT is the leading candidate.

Inheritance tax - The minimum taxable estate would be raised by 50 to 100 percent -- the exact percentage is still to be decided. The current minimum for a surviving spouse with two children is Y32 million ($256,000). The maximum rate would be cut from 75 percent to 70 percent.

Capital gains tax - A flat tax on capital gains is the leading option at the moment. Opposition parties claim that current rules treating most gains as tax-exempt are unfair to lower income taxpayers. The LDP is afraid that it may derail the market's recovery from October's crash.

Alcoholic beverage taxes - As promised, the ad valorem tax system on distilled liquors, wines and domestic counterparts will be dropped. The classification system for spirits will also be abolished (see JEI Report No. 40B, October 23, 1987).

The problem of compensating for the income tax cuts will be lightened by the April 1 end of the tax-exempt small savings accounts (maruyu). On that date, all interest income will become subject to a 20 percent tax. Even if none of the Y300 trillion ($2.4 trillion) currently in maruyu accounts is transfered to higher paying instruments, the government can expect to reap Y1.8 trillion ($1.4 billion) in revenues. Since analysts expect at least some money will seek higher returns, revenues could be even higher.

In the meantime the LDP and the opposition parties continue to wrestle with the final form of the indirect and capital gains taxes. Although the opposition parties have pledged to kill any new major indirect tax, newspaper surveys show that most Japanese are resigned to its introduction. A compromise on a small VAT may be the way out for both sides, since it is not "major" but can be increased in the future if necessary.

Jon Choy

Japanese Firms Increase Capital Spending

Japan's corporate community apparently has been convinced by what the government has been saying for some time: the high yen creates new opportunities. Increased investment by non-manufacturing companies was enough to push up overall plant and equipment spending in 1987, but now even manufacturing

industries are getting into the act. After two years of contraction, plant and equipment spending in the manufacturing sector rose in the October-December period 5.3 percent from the year before.

But it's investment with a difference. According to Ministry of Finance data, those industries particularly well-positioned to profit from expanding domestic demand show the largest increases. For example, steel producers continue to show lower rates of investment than the year before, but the food manufacturing industry is up.

The future apparently will hold more of the same. A survey by the daily Nihon Keizai Shimbun shows that the 1,348 companies questioned expect to increase capital spending by 6.4 percent in fiscal 1988 (April 1, 1988-March 31, 1989), but the plans vary tremendously by industry (see Table). Food manufacturers expect to spend 21 percent more on top of a 35 percent increase this year; steel companies, among the least optimistic, are planning to invest 1 percent less after a 21 percent year-to-year drop in FY 1987.

Japan's Domestic Private Capital Investment*

(in billions of yen and percentage change)

	FY 1987**	1986-87	FY 1988**	1987-88
All industries	Y13,349	1.7%	Y14,208	6.4%
Manufacturing	5,540	-1.9	6,220	12.3
Non-manufacturing	7,809	4.5	7,988	2.3
All industries excluding electric utilities	9,742	3.7	10,632	9.1

*Survey of 1,348 companies.
**Projected figures.

Source: Nihon Keizai Shimbun

Several major exporting industries are increasing spending on new capacity after registering declines last year. The motor vehicle industry, for example, plans a 12.5 percent increase; electrical machinery makers expect a 15.3 percent jump. Some companies with slumping overseas sales find that they still have to invest in new plant and equipment because their existing capacity, though larger than now needed, needs to be kept up-to-date technologically.

Douglas Ostrom

Congressional Trade Concerns Spill Over Into Foreign Policy

Complaints about Japan's trade practices have become standard fare on Capitol Hill. Indeed, they surface in virtually every discussion on trade and other issues affecting the economy. The tendency to single out Japan for complaints -- almost a knee-jerk reaction -- has serious implications for bilateral relations. Perhaps the most obvious consequence of "Japan-bashing" on trade